

## Internal Revenue Service

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### Legend

Distributing =

Controlled =

Business A =

Date A =

Date B =

Date C =

Date D =

Year 1 =

Year 2 =

a =

b =

c =

d =

e =

f =

g =

h =

i =

j =

k =

l =

m =

n =

o =

p =

q =

r =

s =

Dear :

This letter responds to your January 21, 2008 request for rulings as to the federal income tax consequences of a proposed transaction. The information submitted in that request and in later correspondence is summarized below.

The rulings contained in this letter are based on facts and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. This office has not verified any of the materials submitted in support of the request for rulings. Verification of the information, representations, and

other data may be required as part of the audit process. In particular, this office has not reviewed any information pertaining to, and has made no determination regarding, whether the proposed transaction (described below): (i) satisfies the business purpose requirement of § 1.355-2(b) of the Income Tax Regulations; (ii) is used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both (see § 355(a)(1)(B) of the Internal Revenue Code and § 1.355-2(d)); or (iii) is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation or the controlled corporation (see § 355(e) and § 1.355-7).

### Summary of Facts

Distributing is the common parent of an affiliated group of corporations that files a consolidated federal income tax return. Distributing has a single class of voting common stock issued and outstanding. Controlled is the common parent of an affiliated group of corporations that files a consolidated federal income tax return. Controlled currently has two classes of voting common stock issued and outstanding comprised of class A and B stock that differ only in voting rights. The class A stock entitles shareholders to have a vote per share. The class B stock entitles shareholders to have b votes per share. Distributing owns all of the class B stock, which represents c percent of Controlled.

Beginning in Year 1, Distributing undertook a series of transactions that ultimately resulted in the acquisition of a controlling interest in Controlled's stock. On Date A, Distributing purchased approximately d shares of Controlled's Series One voting preferred stock, which represented approximately e percent of the value and total combined voting power of all classes of stock entitled to vote (both common and preferred stock). On Date B, Distributing acquired f percent of all non-employee owned outstanding Controlled stock in exchange for Distributing common stock (the "Reverse Merger"). As part of the Reverse Merger, the acquired shares were cancelled such that virtually all of Controlled's equity (except a relatively small amount of common stock issued and outstanding held by employees and management of Controlled) was comprised of d shares of Controlled's Series One voting preferred stock ("Hot Stock").

During Year 2, Distributing contributed additional capital for additional stock of Controlled. Distributing acquired g shares of Controlled's Series Two voting preferred stock and h shares of Controlled's class A common stock. Distributing also converted approximately \$i of convertible indebtedness into j shares of Controlled's class A common stock.

During Year 2 (following the acquisition of the additional stock described above), Controlled underwent a recapitalization (the "Recapitalization") in which all Series One preferred, Series Two preferred, and class A common stock held by Distributing were

exchanged for k shares of Controlled's class B common stock. Minority shareholders of Controlled exchanged their shares for class A common stock.

During Year 2 (following the Recapitalization discussed above), Controlled effected a reverse 1-for-2 stock split, which resulted in a reduction of the total class A and B common stock. As a result, Distributing's ownership of the class B stock decreased from k to l.

Following the reverse stock split during Year 2, Controlled sold m shares of class A common stock in an initial public offering. As a result of the initial public offering, Distributing's ownership for § 368(c) and § 1504(a) purposes was reduced to approximately n percent (greater than 80 percent) and o percent (greater than 80 percent), respectively.

On Date C, Controlled sold p shares of class A common stock in a secondary public offering. As a result of the secondary offering, Distributing's ownership for § 368(c) and § 1504(a) purposes was reduced to approximately q percent (greater than 80 percent) and r percent (less than 80 percent), respectively. Accordingly, Controlled became deconsolidated from the Distributing affiliated group and discontinued filing a consolidated federal income tax return with Distributing and Distributing's affiliated subsidiaries.

On Date D, Distributing sold s shares of Class B common stock in a private offering. As a result of the sale and in accordance with the terms of the Class B common stock, the Class B common stock sold automatically converted into Class A common stock. The stock sold by Distributing at this time was specifically identified to include the Hot Stock. Accordingly, the Hot Stock will not be distributed to Distributing's shareholders as part of the Distribution.

Upon Distributing's acquisition of Controlled on Date B, both Distributing and Controlled were engaged in Business A. Financial information has been submitted indicating that Business A as conducted by Distributing and Controlled each has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the five years.

Distributing management has determined that the proposed transaction will serve the following corporate business purposes: (i) to facilitate better access by both Distributing and Controlled to the capital markets; and (ii) to provide an expected higher share value for both Distributing and Controlled, which will help both companies more efficiently acquire needed assets and services.

### **Proposed Transaction**

For what are represented to be valid business purposes, Distributing will distribute all of the Controlled stock pro rata to its shareholders (the "Distribution").

### **Representations**

The following representations are made with respect to the Distribution:

(a) Prior to the Distribution, Distributing may sell additional shares of Controlled stock to unrelated third parties. Following any such sales, Distributing will continue to maintain a greater than 80-percent stock interest in Controlled for § 368(c) purposes.

(b) With the possible exception of the issuance of stock or shares pursuant to adjustments to Distributing's existing compensatory options, restricted stock, deferred share arrangements and the issuance of stock or shares pursuant to Distributing's existing convertible debentures, no part of the Controlled shares to be distributed by Distributing to its shareholders will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.

(c) Following the Distribution, Distributing and Controlled will each continue the active conduct of its business, independently and with its separate employees or employees of the other members of its affiliated group.

(d) No person will hold a 50-percent or greater interest in the stock of Distributing or stock of Controlled after the Distribution, within the meaning of § 355(g), who did not hold such an interest immediately before the transaction.

(e) The Distribution will not be used principally as a device for the distribution of the earnings and profits of Distributing, or Controlled, or both.

(f) Other than trade account indebtedness created in the ordinary course of business through continuing transactions at terms arrived at by the parties bargaining at arm's length, payables created for all transitional services, and debt being repaid in connection with the proposed transaction, no intercorporate debt will exist between Distributing and Controlled after all the steps of the Distribution are completed.

(g) Any indebtedness owed by Controlled to Distributing after the Distribution will not constitute stock or securities.

(h) Distributing, Controlled, and Distributing shareholders will each pay their respective expenses, if any, incurred in connection with the Distribution.

(i) Payments made in connection with all continuing transactions, if any, between Distributing and Controlled will be for fair market value based on terms and conditions arrived at by the parties bargaining at arms' length.

(j) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).

(k) Immediately before the Distribution, items of income, gain, loss, deduction, and credit will be taken into account as required by the applicable inter-company transaction regulations (see §§ 1.1502-13 and 1.1502-14 as in effect before the publication of T.D. 8597, 1995-2 C.B. 147, and as currently in effect; § 1.1502-13 as published by T.D. 8597). Furthermore, Distributing's excess loss account, if any, with respect to Controlled common stock or the excess loss account that Distributing may have in the stock of another member that is required to be taken into account by § 1.1502-19(g) will be included immediately before the Distribution.

(l) The Distribution is not part of a plan or series of related transactions (within the meaning of § 1.355-7) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest (within the meaning of § 355(d)(4)) in Distributing or Controlled (including any predecessor or successor of any such corporation).

(m) For purposes of § 355(d), immediately after the Distribution, no person (determined after applying § 355(d)(7)) will hold Distributing stock possessing 50 percent or more of the total combined voting power of all classes of stock entitled to vote, or 50 percent or more of the total value of shares of all classes of stock, that was acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution.

(n) For purposes of § 355(d), immediately after the Distribution, no person (determined after applying § 355(d)(7)) will hold Controlled stock possessing 50 percent or more of the total combined voting power of all classes of stock entitled to vote, or 50 percent or more of the total value of shares of all classes of stock, that was either acquired by (i) purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution, or (ii) attributable to distributions on Distributing stock that was acquired by purchase (as defined in §§ 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution.

(o) The five years of financial information submitted on behalf of Distributing is representative of its present operation, and there have been no substantial operational changes since the date of the last financial statements submitted.

(p) The five years of financial information submitted on behalf of Controlled is representative of its present operation, and there have been no substantial operational changes since the date of the last financial statements submitted.

(q) The Distribution is carried out for the following corporate business purposes: (i) to facilitate better access by both Distributing and Controlled to the capital markets; and (ii) to provide an expected higher share value for both Distributing and Controlled, which will help both companies more efficiently acquire needed assets and services. The Distribution is motivated, in whole or substantial part, by these corporate business purposes.

(r) The Recapitalization qualified as a tax-free reorganization pursuant to § 368(a)(1)(E).

(s) Distributing's acquisition of g shares of Controlled's Series Two voting preferred stock and h shares of Controlled's class A common stock in Year 2 qualified as a tax-free § 351 exchange.

(t) On Date B, Distributing acquired the balance (approximately f percent) of all non-employee owned outstanding Controlled stock. This was preceded by an earlier acquisition of e percent of the total combined voting power of Controlled in Year 1. As a result of these two transactions, Distributing obtained § 1504(a) and § 368(c) control of Controlled.

(u) At the time of the acquisition on Date B, Business A products manufactured and marketed by Controlled were substantially similar to products manufactured and marketed by Distributing.

(v) At the time of the acquisition on Date B, Controlled employed manufacturing techniques similar to those employed by Distributing.

(w) Controlled's design, manufacturing, and testing techniques were dramatically improved by drawing upon the existing experience and know-how of Distributing.

(x) Following the acquisition on Date B, as a result of Distributing's reputation within Business A manufacturing industry, Controlled was able to attract and retain highly qualified specialists essential to expanding Controlled's business.

### **Rulings**

Based solely on the information submitted and the representations made, we rule as follows on the Distribution:

(1) No gain or loss will be recognized by (and no amount will be included in the income of) the shareholders of Distributing on their receipt of the Controlled stock (§ 355(a)(1)).

(2) No gain or loss will be recognized by Distributing upon the distribution to its shareholders of all of the Controlled stock (§ 355(c)(1)).

(3) Each Distributing shareholder's basis in a share of Distributing stock (as adjusted under § 1.358-1) is allocated between the share of Distributing stock with respect to which the distribution was made and the share or shares of Controlled stock (or allocable portions thereof) received with respect to the share of Distributing stock in proportion to their fair market values in accordance with § 1.358-2 (§§ 358(b) and 358(c)).

(4) The holding period of the Controlled stock in the hands of the Distributing shareholder will include the holding period of the Distributing stock with respect to which the Distribution is made, provided that the Distributing stock is held as a capital asset on the date of the Distribution. § 1223(1).

(5) Earnings and profits, if any, will be allocated between Distributing and Controlled in accordance with § 312(h) and §§ 1.312-10 and 1.1502-33.

### **Caveats**

No opinion is expressed about the tax treatment of the proposed transaction described above under other provisions of the Code and regulations or the tax treatment of any condition existing at the time of, or effects resulting from, the proposed transaction that is not specifically covered by the above rulings. In particular, no opinion is expressed regarding: (i) whether the proposed transaction satisfies the business purpose requirement of § 1.355-2(b); (ii) whether the proposed transaction is used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both (see § 355(a)(1)(B) and § 1.355-2(d)); or (iii) whether the proposed transaction is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation or the controlled corporation (see § 355(e)(2)(A)(ii) and § 1.355-7).

### **Procedural Statements**

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent. A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of this letter ruling.



In accordance with the power of attorney on file in this office, a copy of this ruling letter is being sent to your authorized representative.

Sincerely,

*Richard K. Passales*

Richard K. Passales  
Senior Counsel, Branch 4  
Office of Associate Chief Counsel  
(Corporate )